

# **CITY AUDITOR'S OFFICE**



## **AUDIT OF CITY INVESTMENTS**

**Report No. CAO 601-0102-04**

**September 27, 2001**

**RADFORD K. SNELDING, CPA, CIA, CFE  
CITY AUDITOR**



MAYOR  
OSCAR B. GOODMAN

CITY COUNCIL  
GARY REESE  
(MAYOR PRO-TEM)  
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CITY MANAGER  
VIRGINIA VALENTINE

September 27, 2001

Mayor Oscar B. Goodman  
Councilman Gary Reese (Mayor Pro-Tem)  
Councilman Michael J. McDonald  
Councilman Larry Brown  
Councilwoman Lynette Boggs McDonald  
Councilman Lawrence Weekly  
Councilman Michael Mack  
City of Las Vegas Audit Committee

Subject: CAO 601-0102-04 - Audit of City Investments

Attached please find the report mentioned above. Management comments are included in the report.

Sincerely,

A handwritten signature in dark ink, appearing to read "Radford K. Snelding", is written over a horizontal line.

Radford K. Snelding, CPA, CIA, CFE  
City Auditor

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# **EXECUTIVE SUMMARY**

## **AUDIT OF CITY INVESTMENTS**

### **REPORT CAO 601-0102-04**

The purpose of the executive summary is to convey in capsule form the significant issues of the audit report. The executive summary is a vehicle for reviewing the report and should be used in conjunction with the entire report.

#### **INTRODUCTION**

The Treasury Division is part of the Department of Finance and Business Services. The Treasury Division is charged with investing and overseeing the investment of the City's funds by providing reasonable protection of principal and maximizing total return in accordance with the City's investment policy and philosophy. The City maintains an investment portfolio of over \$400 million as of May 22, 2001. In addition, the City has approximately \$380 million in outstanding debt as of the same date. The average rate of return on its investments was 5.67% last year. The average weighted maturity is 1.72 years. The budget for expenditures was \$462,339 and \$434,879 for fiscal years 2000 and 2001, respectively.

#### **OVERVIEW OF SIGNIFICANT ISSUES**

We believe that controls and practices related to the City's investments need improvement.

Our audit identified areas that management should consider which could improve efficiency.

- No sweep account is being used to invest idle funds.
- An investment committee does not exist to oversee the investment function.
- A trading policy does not exist to ensure responsible trading is performed.
- The custody agreement has not been revised since 1994.
- Trade settlement segregation of duties are not adequate and should be reviewed by the Treasury Division.



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## BACKGROUND

## OBJECTIVES

- Determine whether City assets are safeguarded from loss.
- Review compliance with laws, regulations, and policies.
- Review and evaluate operational, financial, and system controls.

- Reviewing policies and procedures;
- Reviewing the City Charter;
- Interviewing staff and management;
- Observing operations;
- Analyzing both financial and operational data; and
- Evaluating security and access controls.

THREE DOLLARS

Bank of Michigan

THREE DOLLARS

## **1. CASH MANAGEMENT – SWEEP ACCOUNT**

### **Criteria:**

- A sweep account should be utilized to place idle funds in interest bearing status.

### **Condition:**

- The Treasury division does not currently use sweep accounts.
- From July 2000 to May 2001, the City's main checking account had an average daily balance of \$2.06 million. Sweep accounts currently earn between 3-4% depending upon liquidity. At these rates, the City would earn between \$61,800 and \$82,400.
- From July 2000 to May 2001, the average collected balance was \$480,000. The City would earn between \$14,400 and \$19,200 by sweeping these funds.
- This only takes into consideration the City's main checking account. The City currently has 19 other bank accounts which use of a sweep account would increase the amount the City would earn.

### **Effect:**

- Potential loss of investment income.

### **Cause:**

- The Treasury division has not adequately considered the benefits of using sweep accounts.

### **Recommendation:**

The Treasury division should evaluate and document the use of sweep accounts and cash management techniques for all City bank accounts to maximize the use of the City's funds.

### **Management's Plan of Action:**

Treasury agrees that sweep accounts should be considered in a banking service request for proposal, but it is unlikely that any interest gained will exceed the savings in banking charges under our current banking contract. First, the average "collected" balance for the above period was only \$480,000, so the potential interest earnings would be much less than \$30,000. Our current banking contract provides free services in consideration of a compensating balance. The bank calculates the value of these free services at about \$170,000 annually, but Treasury estimates that they are worth about \$85,000. Since these services would no longer be free if sweep accounts were utilized, it is unlikely that the net effect will be beneficial to the City (i.e., pay \$85,000 to gain \$30,000). Treasury will continue to evaluate the use of sweep accounts. As part of the banking service RFP, Treasury will contact other entities to gain insight into their use of sweep accounts, if any.

**Timetable:    October 1, 2001**



## **2. INVESTMENT COMMITTEE**

### **Criteria:**

- An investment committee can be utilized to oversee and provide input on investment policy and practice.

### **Condition:**

- One employee makes the City's investment decisions on a portfolio valued over \$400 million.

### **Effect:**

- The City could be missing out on investment opportunities with greater security and return by only having one person making investment decisions.

### **Cause:**

- Management has not established an investment committee.

### **Recommendation:**

Finance and Business Services should evaluate and document the benefits of an investment oversight committee. Based on this evaluation, Finance and Business Services should consider establishing an investment oversight committee.

### **Management's Plan of Action:**

The City's three principal objectives in managing the investments are, in order of importance, (1) to provide safety, (2) to ensure liquidity, and (3) to generate a market rate of return on the investments. Furthermore, Nevada Revised Statutes restricts the local governments investment options, placing additional emphasis on safety. Treasury believes it will be extremely difficult to identify potential committee members that understand municipal investment strategy, or that will be able to resist encouraging the City into riskier investment strategies, thereby jeopardizing our most important investment policy: safety. Nonetheless, Finance and Business Services in conjunction with the City Manager's Office will evaluate the advantages and disadvantages of an investment committee and decide whether or not such a committee would enhance the City's investment function.

**Timetable:    October 1, 2001**



### 3. TRADING POLICY / PROCEDURES

**Criteria:**

- Policy and procedure manuals improve operations by providing uniformity in practices, establishing clear lines of responsibility, and enhancing employee accountability.
- Securities files should be complete including financial statements and analysts' reports.
- Broker/Dealers used should be on an approved list.
- Good business practice states that concentrated trading (over 20%) should not occur between a broker and a trader.
- A formal process should exist for resolving incorrect or failed trades.

**Condition:**

- The City does not have a trading policy.
- While the City currently runs employee background checks with the FBI and the State of Nevada, they only address criminal matters.
- The City's Code of Ethics is only reviewed or certified at the time of initial employment.
- Management does not routinely review investment transactions.
- Segregation of duties does not exist between the approval and the recording of the investment activity. The trader enters trade information from the trade into Sympro (investment software) which is then uploaded to the accounting system. The trader is approving / authorizing the transaction and recording the transaction in the Oracle financial system.
- Financial statements and analysts' reports are not maintained for all trades.
- The City has a list of investment brokers but there is not a list of approved broker/dealers or a limit to the amount of trading between a broker and a trader.
- There is not a formal process in place for resolving incorrect or failed trades.

**Effect:**

- Lack of uniformity in how procedures are followed.
- Lack of accountability of employees.
- Potential mishandling of funds or fraud.
- Information related to a trade allows others to review the file and determine why a particular trade was performed.
- Without a list of approved broker/dealers and controls to ensure a limit to the amount of trading between a broker and a trader, a trader could show favoritism.
- By not having a formal process in place to resolve incorrect or failed trades, the City could potentially lose money or not receive a security.

**Cause:**

- Treasury Management has not developed a formal written trading policy.
- Risk of trading without proper segregation of duties has not been fully evaluated by management.





- Lack of document retention standards.
- Lack of controls to limit broker/dealer activity.
- The Treasury Division does not have anyone besides the trader settling the trade.
- Traders perform trades based on system information but do not maintain detailed records related to the decision making process for the trade.
- The process for handling incorrect or failed trades, while infrequent, is not formalized.

**Recommendations:**

1. The Treasury Division should establish a formal written trading policy. This policy should address at a minimum the following:
  - Proper authorization of transactions;
  - Adequate segregation of duties;
  - Adequate documents and records;
  - Adequate safeguards over access;
  - Independent verification;
  - Comprehensive background investigation of employees; and
  - Periodic acknowledgement and evidence of ethical responsibilities.
2. The Treasury Division should become more actively involved in monitoring security trades.
3. The Treasury Division should create a list of approved broker/dealers, implement procedures to ensure only these brokers are being used, and develop controls to minimize the risk of concentrated trading.
4. Traders should maintain detailed records as support for trades.
5. A formal process should be developed for resolving incorrect or failed trades.

**Management's Plan of Action:**

Treasury believes that procedures have been in place to safeguard the investment portfolio, but acknowledges that they are not formalized in a written policy. The Treasurer will publish an investment procedure that will address the issues enumerated above.

**Timetable: December 1, 2001**

**4. CUSTODY AGREEMENT**

**Criteria:** Good business practices include annual reviews by management of the cost and quality of services being provided by vendors along with competitive bidding to ensure the best value for cost incurred.

**Condition:**

- The Bank of New York provides our custodial services for approximately \$90K per year under the same custody agreement the City had with Bank of America dated August 11, 1994.



- A Request for Proposal (RFP) for custodial services has not been issued for over six years.
- Under the current agreement, the custodian can liquidate securities if settlement is not made in a timely manner.
- Internal auditors or external auditors do not have the explicit right to inspect, verify, or confirm the securities.
- Part of the custody agreement could not be located by the Treasury Division.

**Effect:**

- The rate being charged and services being provided for custodial services may no longer be competitive with other providers.
- The custodian could sell investments without prior approval.
- Without the entire agreement, the Treasury Division cannot ensure the custodian upholds their part of the agreement.
- Without an audit clause, the City may not have the right to inspect its securities.

**Cause:**

- Management has not adequately considered the benefits of reviewing the costs and services currently being provided by its custodian.
- Management has not reviewed the adequacy or completeness of the custodian agreement.

**Recommendations:**

1. The Treasury Division should determine if the fees the City pays are reasonable and if not then work with Purchasing to issue an RFP.
2. City Management and the City Council should periodically review and approve the custody agreement.
3. The Treasury Division should amend the agreement or include in a new agreement that the custodian cannot assign, pledge, encumber, or dispose of any security except in acting as directed by the City of Las Vegas.
4. The Treasury Division should ensure that future agreements include the right to inspect the securities.
5. The Treasury Division should ensure that all future agreements are complete and secured.

**Management's Plan of Action:**

Treasury will do an analysis of fees being charged to determine whether or not these fees are reasonable, and if not will initiate a competitive process for award of these services. **Timetable—November 1, 2001.**

The formalized investment procedures will include provisions for reviewing the custody agreement. **Timetable—December 1, 2001.**

The existing custodian agreement will be amended, or any new agreement entered into, shall contain limitations on the custodian so they cannot assign, pledge, encumber, or dispose of any security unless they are directed by the City. **Timetable—August 1, 2001.**



Consistent with new city policy, all future agreements will include an audit clause that would give the City the right to inspect its securities. **Timetable—August 1, 2001.**

Treasury will obtain a copy of the current custody agreement and compare it to what is on file to determine if documents are indeed missing. **Timetable—August 1, 2001.**

**Timetable—December 1, 2001.**

## 5. INVESTMENT POLICY

### Criteria:

- A comprehensive written policy should govern the practices of critical operations.
- An investment policy should
  - have revenue goals.
  - indicate who has investment authority.
  - define a plan for assessing the liquidity needs of the City.
  - define a methodology to evaluate and monitor portfolio results.
  - compare the City's investments with appropriate benchmarks.
- The Investment Policy states, "The City Treasurer shall send annually the current edition of this investment policy to all institutions which are approved to handle City investments".
- Municipal Treasurers' Association of the United States and Canada Investment Policy Certification program exists to protect the investment officers as well as showing commitment to a quality investment program and the safety of the City's funds.
- An Investment Policy should state when Investment Reports are going to be released.

### Condition:

The following are exceptions to the Investment Policy or issues that should be addressed in the Policy:

- According to the investment pool report, the average weighted maturity for the portfolio is 1.72 years as opposed to 2.0 years.
- The City of Las Vegas Investment Policy includes the year of revision on it but not the specific date.
- The Treasury Division did not achieve the percent of investment pool targets in 4 out of 5 categories. See table on next page.

Maturity	0-1 year	1-2 years	2-3 years	3-4 years	4-5 years
% of Pool	30%	20%	20%	15%	15%



Target Range	25-35%	25-35%	15-25%	10-20%	10-20%
Actual	22%	47%	7.9%	15.9%	1.5%

- The Investment Policy does not list revenue goals.
- The Treasury Division has not sent the Investment Policy to all institutions annually except during the past year.
- The City's investment policy is based on the Municipal Treasurers' Association of the United States and Canada Model Investment Policy and was certified in 1992, however it has not been recertified as recommended by the Municipal Treasurers' Association.
- The Fourth Quarter Investment report was not released until November 2000. The Quarterly Investment Report is to be released a month after the end of the quarter.

**Effect:**

- The City could fail to follow required or desirable practices.

**Cause:**

- The Treasury Division is not following all established practices.
- The Investment Policy does not address certain desirable practices.

**Recommendations:**

1. The Treasury Division should evaluate the impact of not meeting the duration target of 2 years for the portfolio or change the policy as appropriate.
2. The Treasury Division should ensure that the Investment Policy includes the revision date.
3. The Treasury Division should review the maturity pool guidelines and make adjustments to the policy as necessary.
4. The Treasury Division should review and annually send the current Investment Policy to all institutions approved to handle City investments as required by the Investment Policy.
5. The Treasury Division should consider having the Investment Policy recertified by the Municipal Treasurers' Association of the United States and Canada according to the Municipal Treasurers' Association schedule.
6. The Investment Policy should identify when the Quarterly Investment Report should be published.

**Management's Plan of Action:**

The Quarterly Investment Report evaluates the portfolio performance against the investment strategy targets. Rather than revise the targets with changing economic conditions, we explain the reasons why the actual maturity periods vary from the target. Treasury will review the appropriateness of revising the investment strategy targets more frequently in consideration of the changing market trends. **Timetable--November 1, 2001.**

The updated Investment Policy will include the month, day, and year of the revision. **Timetable—March 1, 2002.**



Treasury believes that current maturity guidelines are satisfactory, and that current maturities are in line with those guidelines.

Treasury will issue an annual email to all institutions approved to handle City investments notifying them of the availability of the City's investment policy on the City's Internet web site. This will coincide with an annual policy review. **Timetable—March 1, 2002.**

The Treasurer will submit the revised investment policy for re-certification by the Municipal Treasurers' Association. **Timetable --June 1, 2002.**

A time frame for the publication of the quarterly Investment Report will be determined and it will be incorporated into any and all revisions of the Investment Policy.

**Timetable— June 1, 2002.**

## **6. PROFICIENCY / TRAINING OF BACKUP INVESTMENT PERSONNEL**

### **Criteria:**

- Good business practices require backup personnel be designated and trained to handle everyday activities in case of extended absence or separation.

### **Condition:**

- While a backup employee has been designated to cover investments, the employee has not been trained in all aspects of the City's investments and use of the Sympro system.
- The previous investment officer left with only two weeks notice.

### **Effect:**

The Treasury Division may be without adequately trained personnel to cover investments.

### **Cause:**

- Inadequate or incomplete cross training.

### **Recommendation:**

The Treasury Division should have backup personnel trained in all aspects of the investment process and systems.

### **Management's Plan of Action:**

Treasury agrees that additional backup training is needed due to the limited number of professional staff assigned to the office.

**Timetable: On going.**



## **7. SURETY BOND**

### **Criteria:**

- Insurance such as a surety bond should adequately cover the potential risk.
- According to the City Charter, the City Treasurer must provide a surety bond in the amount which is fixed by the city council (3.150) 2(b).

### **Condition:**

- The City pays \$17,300 every two years for a surety bond which covers:
  - Public employee dishonesty – Per loss: \$250K,
  - Faithful performance: \$250K, and
  - Forgery or alteration: \$250K.
- The investment portfolio is in excess of \$400 million.

### **Effect:**

- The City may not be adequately covered with its existing surety bond.

### **Cause:**

- Management has not adequately considered the risk of loss under its current surety bond.

### **Recommendation:**

1. The Treasury Division through consultation with risk management professionals should determine the appropriate level and type of coverage to manage this risk and institute changes as appropriate.

### **Management's Plan of Action:**

Treasury will consult with the Human Resource risk manager on the possibility of engaging a third party that specializes in investment and reinvestment risks and identify any internal control weaknesses that could put the City over the current blank surety bond limit of \$250,000. Treasury will contact the State Treasurer's Office and Clark County local governments to see what their level of bond coverage compare to the size of the investment portfolios.

**Timetable: December 31, 2001**



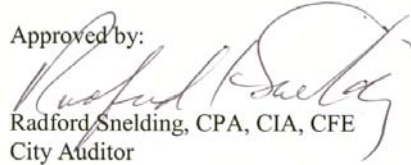
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